Internal Revenue Service

memorandum

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Br1:WEWilliams

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to: Bob S. Blumenfeld, ETA
CP:IN:C:E:655

from: Chief, Branch No. 1
Associate Chief Counsel (International) CC:INTL:1

subject: [redacted] Gift

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This responds to your request for our views with respect to an issue that has arisen in this case.

Issue:

Whether a gift in [redacted] of [redacted] shares of stock in [redacted] by [redacted], an Israeli citizen who renounced his U.S. citizenship in [redacted] to his son is subject to U.S. gift tax under I.R.C. § 2501(a)(1)?

Background

[redacted] was born in what is now Israel on [redacted] He fought in the war that resulted in the establishment of Israel and thereby became a national of the newly-formed state. In [redacted], he emigrated to the U.S. and became a naturalized U.S. citizen on [redacted]. He retained his Israeli citizenship as well.

In [redacted], [redacted] founded [redacted] ([redacted]), a Panamanian corporation which has been very successful, and one class of its stock (Class A) is listed on the New York Stock Exchange. [redacted] headquarters is in [redacted]. [redacted] has two classes of stock: Class A Common Stock which has been publicly traded since [redacted] when [redacted] made its first public offering ([redacted] shares outstanding); and Class B Common Stock which is not publicly traded ([redacted] shares outstanding). Each Class A share has

one vote (a total of [redacted] votes), and each Class B share has five votes (a total of [redacted]).

All of the Class B shares are owned by a U.S. partnership, [redacted]; and [redacted] percent of the Class A shares are owned by [redacted].[1]/ [redacted] owns two U.S. grantor trusts, one for each class of [redacted] stock. [redacted] has a [redacted] percent interest in [redacted] his wife and children have a [redacted] percent interest in [redacted]; and the remaining [redacted] percent interest is owned by [redacted] irrevocable trusts the beneficiaries of which are [redacted] children.

[redacted] apparently contributed [redacted] Class A shares (out of a total outstanding of [redacted]) to [redacted] and his wife and [redacted] children contributed [redacted] shares.

On [redacted] [redacted] renounced his U.S. citizenship at the U.S. Embassy in [redacted]. In [redacted] taxpayer gave his son, [redacted] Class A shares of [redacted] The IRS has tentatively placed a value of approximately $[redacted] on the gift. [redacted] is a U.S. citizen and resident. Apparently, no gift tax return was filed for this transfer.[2]/

Discussion

The issue on which you requested our views is whether there is a basis for the IRS to argue that the [redacted] gift of securities worth approximately $[redacted] is subject to U.S. gift tax.

The general rule, under I.R.C. § 2501(a)(1), is that a gift tax, computed under section 2502, is imposed "on the transfer of property by gift ... by any individual, resident or nonresident." The general rule is qualified in section 2501(a)(2) with respect to transfers of intangible property by a nonresident alien. Pursuant to section 2501(a)(2), with one exception, a gift tax is not imposed on "the transfer of intangible property by a nonresident not a citizen of the

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[1]/ The remaining [redacted] percent of the Class A shares (publicly traded on the N.Y. Stock Exchange) are owned by approximately [redacted] shareholders.

[2]/ Mr. Blumenfeld estimates that the gift tax on this gift could exceed $[redacted], with an additional $[redacted] in penalties.

United States. [Emphasis added.]" The rule in section 2501(a)(2) that a nonresident alien is not subject to gift tax on the transfer of intangible property applies whether the intangible property is located within or outside the U.S.

The one exception to the rule in section 2501(a)(2) is in section 2501(a)(3). This exception applies in the case of a donor who lost his U.S. citizenship during the 10-year period ending with the date of transfer, unless the loss of citizenship resulted under certain specific statutes or the donor rebuts the presumption that the loss of citizenship had "for one of its principal purposes the avoidance of taxes". If a nonresident alien donor fails to rebut the presumption that his loss of U.S. citizenship had a principal purpose of tax avoidance, the rule in section 2501(a)(2) that a transfer of intangible property, whether located within or outside the U.S., is not subject to federal gift tax is inapplicable. However, in the case of a nonresident alien donor to which section 2501(a)(2) is inapplicable, tax applies only to property (whether real or personal, tangible or intangible) situated in the U.S. at the time of the transfer. See Treas. Reg. § 25.2511-3(a)(2)(i). Further, shares of stock in a foreign corporation (such as [redacted]) is property situated outside the U.S. regardless of where the stock certificates are actually located. See Treas. Reg. § 25.2511-3(b)(3)(ii).

Accordingly, federal gift tax will apply to [redacted] transfer of the [redacted] shares to his son only if [redacted] was a resident of the U.S. for gift tax purposes (i.e., domiciled in the U.S.) on the date of the gift in [redacted]. If [redacted] was a nonresident of the U.S. (i.e., not domiciled in the U.S.), his transfer of the [redacted] shares to his son is exempt from federal gift tax under section 2501(a)(2); or if the exemption in section 2501(a)(2) is inapplicable to the transfer, because of section 2501(a)(3) (i.e., [redacted] fails to rebut the presumption that his loss of U.S. citizenship had a principal purpose of tax avoidance), his transfer of the [redacted] shares to his son is not subject to gift tax because the shares of stock in a Panamanian corporation are treated as property situated outside the U.S..

Accordingly, if [redacted] was not a U.S. resident on the date of the [redacted] gift, the result will be the same whether or not tax avoidance was a principal purpose for his renunciation of his U.S. citizenship. Therefore, we will not discuss the facts supporting the position that he renounced his U.S. citizenship for tax avoidance purposes.

Whether [redacted] was domiciled in the U.S. at the time of his gift in [redacted]?

As pointed out above, the gift tax is not imposed on the transfer of intangible property or property not situated in the U.S. by an alien who is not a U.S. resident. In [redacted] was an alien. The question is whether he was a resident of the U.S.

For purposes of the gift tax, section 25.2501-1(b) of the Regulations defines "resident" as follows:

> A resident is an individual who has his domicile in the United States at the time of the gift. For this purpose the United States includes the States and the District of Columbia. ... All other individuals are nonresidents. A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of moving therefrom. Residence without the requisite intention to remain indefinitely will not constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal. [Emphasis added.]

Prior to the amendment of section 7701 in 1984, by enactment of subsection (b) containing a mathematical test for determining whether an alien is a U.S. resident for income tax purposes, the tendency of the courts was to treat "residence" and "domicile" as having the same meaning. See Green, 62-1 U.S.T.C. para. 9343 (E. D. Mich. 1962), in which the court observed that "[s]ince the Revenue Code does not distinguish between 'residence' and 'domicile', the terms are synonymous."

One purpose of the enactment of the objective test of "residency" in section 7701(b) was to eliminate the requirement that a subjective intent to remain at the location be established for residency. Section 7701(b) was enacted by the Deficit Reduction Act of 1984, P.L. 98-369, § 138(a). The amendment to section 7701(b) originated in the House. The Ways and Means Committee Report contains the following:

> The Internal Revenue Code does not define the terms "resident alien" or "nonresident alien." Treasury Regulations generally apply a subjective test and define the terms on the basis of an alien's intentions with regard to the length and nature of his or her stay (Treas. Reg. sec. 1.871-2).

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> The committee believes that the tax law should provide a more objective definition of residence for income tax purposes.
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> The bill provides a definition of resident alien for U.S. income tax purposes. (The bill does not affect the definition of resident for Federal estate or gift tax purposes). [Emphasis added.]

H. Rep. No. 98-432 (Part 2), 98th Cong., 2d Sess. 1523-1525 (March 5, 1984).

The definition in section 25.2501-1(a)(3)(i) of the Regulations, which defines "resident" for gift tax purposes as "an individual who has his domicile in the United States at the time of the gift" (emphasis added) was adopted in T.D. 6334, 1958-2 C.B. 627, 631. Section 7701(b)(1) specifically states that the definition of "resident" does not apply for purposes of subtitle B (i.e., Estate and Gift taxes). Therefore, the definition of "domicile" is found in the Treasury Regulations and case law.

The issue in Niki v. Commissioner, T.C. Memo. 1963-133, 22 T.C.M. 644, was whether petitioner was domiciled in California for purposes of the community property laws of that state. However, the question did not turn on the local law definition of "domicile". The Tax Court observed the following:

> We find no real distinction between the law of California and that of other jurisdictions with respect to the principles governing a determination of an individual's domicile. We approach decision upon the definition enunciated by the Supreme Court in Texas v. Florida, 306 U.S. 398:
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> > Residence in fact, coupled with the purpose to make the place of residence one's home, are the essential elements of domicile.

With respect to "purpose", the Tax Court observed that "[t]his is a question of fact to be decided upon the particular circumstances shown by this record."

Similarly, the district court in Green v. United States, supra[3]/, held that

> "Domicile" ... means living in a locality with intent to make it a fixed and permanent home, while "residence" simply requires bodily presence as an inhabitant in a given place.

The facts that you provided us indicate that [redacted] was present in the U.S. for [redacted] days in [redacted] and for [redacted] days in [redacted]. We do not know the number of days (if any) that he was present in the U.S. in [redacted], the year the gift in question was made to his son. If he was not present in the U.S. in [redacted] it is our view that he was not domiciled in the U.S. during the year that the gift was made.

Even assuming that [redacted] was present in the U.S. during [redacted] it is doubtful that the facts will support the position that he intended to make the U.S. his permanent home. However, resolution of this question will depend on the substantiality of [redacted] personal, civic, and business ties to Israel versus his ties to the U.S. In this regard, [redacted] apparently ceased active management of [redacted] in [redacted] dated [redacted]. An article in [redacted] includes the following:

[redacted]

* * *

[redacted]

We note that the International Examiner's memo dated [redacted] states that after moving to Israel, [redacted] "began some business enterprises there and was subject to tax on the profits derived therefrom." While such profits appear to be

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[3]/ The issue in Green was whether Ms. Green was a nonresident alien during 1958. If a nonresident, she and her husband had improperly filed a joint income tax return under section 6013(a)(1).

minimal in relation to [redacted] profits, the fact that [redacted] began businesses in Israel indicates an intention to remain there permanently.

To successfully defend a position that [redacted] was domiciled in the U.S. in [redacted] even though not a U.S. resident for income tax purposes under the numerical test in section 7701(b), there will need to be substantial factual development. To succeed in arguing that [redacted] was domiciled in the U.S., the IRS will need to present evidence that he was actually present in the U.S. during the year and that it was his intention to make the U.S. his permanent home. It is our view that the facts are likely to indicate that [redacted] was domiciled in Israel in [redacted]

Conclusions and recommendations:

It is our view that the facts are unlikely to support the position that [redacted] was domiciled in the U.S. on the date of the gift to his son in [redacted] While he may or may not have been present in the U.S. on the date of the gift, the facts will probably not support an argument that [redacted] intended to make the U.S. his permanent home. It is our view that both physical presence and an intent to make the U.S. a permanent home are required for domicile; and that without both, a person is not a resident of the U.S. for gift tax purposes.

With respect to whether tax avoidance was a principal purpose for renouncing his U.S. citizenship, the burden of proof would be on [redacted] However, as discussed above, the federal gift tax will not apply regardless of whether [redacted] were to carry his burden of proof with respect to the tax avoidance issue. That is, [redacted] is a Panamanian corporation, and its shares of stock "constitute property situated outside the United States." Under section 2511(a) and section 25.2511-3(a) of the Regulations, a transfer of property by an expatriate for whom section 2501(a)(2) is inapplicable is subject to federal gift tax only if the property is situated in the U.S.

Therefore, unless the IRS is able to establish that [redacted] was domiciled in the U.S. in [redacted] we do not recommend that the IRS take the position that the gift tax under section 2501(a)(1) applies to [redacted] transfer of the [redacted]

shares to his son in [redacted]. We doubt that the evidence will support the position that [redacted] was a U.S. domiciliary in [redacted]

If you have any questions, please call Ed Williams at 874-1490.

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